Estate and Taxation Planning Council Presentation – May 2022
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PRESENTATION NOTES AND TALKING POINTS

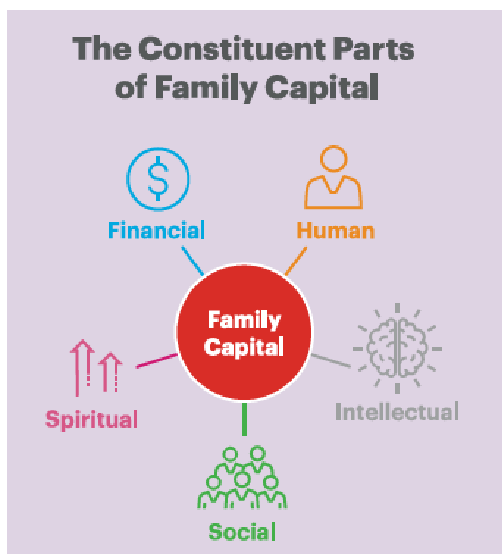
1. Henry describes his role as specialising in the organisation of family capital. What does he mean by family capital?

One of my most admired thought leaders is a US advisor called Jay Hughes. After a major midlife crisis, Jay realized that his work in the law had a major flaw being that he was the only person who could use the structures he was creating for clients. He understood that the responsibility of a professional is to make clients more capable and liberate them, but he had made them less capable. He started focusing more on ideas to make families more independent and also shared these ideas. Jay started to shift away from legal structures which were focused more on the 'How?' questions and move towards the 'Why?' questions which had more impact on families.

Using this perspective it could be said that there are **five constituent parts to family capital**:

- **Spiritual Capital**: This refers to a common purpose where every member of the family by affinity seeks to enhance the other's journey of happiness.
- **Social Capital**: Can you make really good joint decisions together over a long period of time?
- **Intellectual Capital**: To make good joint decisions, there has to be a learning system where what is learned is shared.
- **Human Capital**: This is the individual family members and the people who serve them.
- **Financial Capital**: This is the engine that grows the other forms of capital and does not simply function as accumulated wealth.

It is critical to understand that the qualitative forms of capital must always be kept in focus above the financial capital that is meant to support them; a family that simply focuses on putting financial capital into consideration is not likely to succeed together.



On a day-to-day level my work involves having client relationships with individuals and families (more so than corporates or institutions) and helping them to **create, preserve, grow, and protect family capital**.

This requires (among other things):

- A deep understanding of circumstances and objectives.
- Strong technical knowledge and application of the law (sometimes eschewing “commercial” or “practical’ solutions to the chagrin of clients and other advisors).
- An ability to identify and assess risks.
- A toolbox of solutions to achieve the objectives and manage the risks.
- A commitment to professional development and learning from international best practice.
- Collaboration with a network of advisors in **ten domains of family wealth** (which I will speak to further shortly).

2. Henry describes how he came to be doing this work and what connects him with it:

I became a private wealth advisor by accident rather than design. I grew up in rural North Canterbury and graduated from the University of Canterbury Law School in 2002 with no idea what I wanted to do with my degree. I have always been a grafter and intellectually curious hard worker. My grades were pretty average compared to the CVs of the current generation of law graduates. I would have loved to have been a professional athlete, but that didn’t really work out and so I defaulted into the law.

In my first job I rotated around various practice areas without really finding anything that excited me.

I then took a job in a **general practice in the Cook Islands** where I practiced just about every type of law you could imagine. In a typical day I might cover criminal, commercial, tax, civil litigation, estate planning, maritime, and indigenous land law.

During that fun phase of my career I got involved in some trust-busting cases – acting for foreign creditors of Cook Islands trusts to make claims against the trustees and claw back the assets.

Because the Cook Islands does not have a suite of legislation which is as comprehensive as NZ, we would rely a lot on common law and equitable principles that had been developed by the courts, rather than parliament.

So it required me to develop a good knowledge of black letter law – especially in relation to the law of trusts.

For the first time in my career I developed a genuine interest in a specific area of the law.

In parallel to that I developed an interest in offshore finance, by which I mean the practice of a person or business in one country with interests in a second country using a third country as a facilitator of transactions and/or custodian of property.

I moved to Jersey where I practiced for 10 years in an **international law firm** called Mourant where I was mentored by and worked with some of the best trusts lawyers in the world on some very interesting and complex matters involving the structuring of private wealth and resolution of disputes relating to private wealth.

I was very content in Jersey and could have happily spent the rest of my career there. But I was lured back to NZ in 2016 by Tim MacAvoy who was planning for retirement and had identified me as someone to whom he was willing to pass on his practice. I have been in the role for about 6 years now and have no regrets.

Like most people I work out of necessity to provide for my family. But of course I could be doing transactional work for blue chip corporates which, especially in a big firm, is the most highly prized and perceived as being more exciting work. I have done quite a lot of corporate and funds work but always in a private client context.

So I do what I do partly because I don’t know anything different. But I really enjoy the technical and academic aspects of the law. In some practice areas the law and technical ability is less important, but in what I do it is critical, and you really can’t fake it.

I work really hard at **professional development** – I read books, cases, and journals from all over the world and for several hours a week.

I also enjoy (most) client relationships with real people from all walks of life and collaborating with other experts (it's much more difficult with non-experts).

The nature of this work also provide opportunities to make **social and community impact**. Increasingly that is the type of work that I am more attracted to.

3. Henry describes his typical clients:

Some of my clients are truly extraordinary people who are **founders of businesses that have literally changed the world**.

Many clients are members of **business owning families**.

I do a lot of work with young athletes and founders at the beginning of their wealth creation journey.

I advise grant makers and donors in relation to **strategic philanthropy** as well as the charities doing the programme delivery. Live Ocean and Save the kiwi are two causes that I am particularly passionate about.

I am also an advocate for Community Foundations as an efficient form of philanthropy and new way of thinking about giving to charity. Similarly, I am attracted to social enterprise and the concept that in fiduciary and commercial arrangements purpose can be aligned with profit.

I work with financial institutions, trustees and other professionals who advise private clients to help them operate their businesses and **manage regulatory and fiduciary risk**.

I get involved in resolving **family disputes** and in **relationship property** matters (front end and back end).

I do a lot of work with **new migrants** to help them get residency by investment in NZ and then deal with issues such as tax, estate planning, acquiring assets, etc.

I do some court appointed property management work too.

4. Henry shares international thought leadership that has influenced his own thinking:

I am quite influenced by The UHNW Institute, a non-profit and independent "Think Tank", publisher and curator of exceptional thought leadership and content relating to private wealth. One of their seminal works is a White Paper is The 10 Domains of Family Wealth. The diagram below illustrates all the areas where advice is required and when examined through that prism it soon became clear to me that I am not an expert in all these areas.

The various domains are also complex and genuine expertise is required to properly advise clients. That usually requires an **open architecture** approach to advice as almost no one service provider will have all the solutions. If they claim they do, then they are almost certainly overstating their capabilities.

I subscribe to a philosophy known as "integrated family wealth services", another concept developed by The UHNW Institute.

In short there are **four levels of integration**:

- **Siloed** providers with little to no integration (e.g. lawyers, accountants, financial planners, etc all working in isolation of each other);
- **Integrated financial management** (i.e. some combination of financial planning, tax planning, portfolio design, investment management, retirement planning, and insurance planning);
- **Integrated wealth management** (i.e. all of the above but with estate planning and legal, risk management, administration and consolidated reporting, and perhaps philanthropic planning); and
- **Family wealth integration** (i.e. where a few family offices and firms with the close collaboration of high-quality outside providers provide or procure all of the above services as a cohesive unit in a process that takes into account all the domains of a family's wealth).

In my experience, **high levels of integration in the management of family wealth are worth striving for**. Put another way, service providers and advisors working in silos is highly undesirable and usually detrimental to the preservation and enhancement of family wealth.

Unfortunately, this can often happen when a so-called "trusted advisor" is also the gatekeeper to a family. I think that the affairs of wealthy families in 2022 are far too complex to be entrusted to one advisor and a better approach is for there to be **a team of trusted advisors**.

If that proposition can be agreed then it becomes a matter of organization, collaboration, integration, and execution. Integration can be achieved with some purposeful planning, strong leadership, and a collaborative service provider-advisory group that sees the bigger picture and is willing to leave egos and self-interest at the door.

5. Henry observations on the NZ estate planning landscape:

I think we lost our way in the 1980s due to an obsession with avoiding estate taxes by setting up trusts without any consideration for the unintended consequences relating to succession. For reasons I have never understood we continued this practice long after estate duties were repealed. We have not yet gotten back on course, and it sometimes feels like we do things in a vacuum of free thinking and intellectual rigor.

Having spent most of my career offshore I still find it very peculiar to see how trusts are used, set up, and operated in NZ. In other countries, trusts are typically used by the wealthy or the vulnerable. In NZ, family trusts are ubiquitous, and it is common for people of quite modest means to hold assets in a trust. Sometimes a family will have several trusts, each of which warehouse a single asset class or only a few assets.

Trusts have become a default setting and, furthermore, it seems to be the norm in NZ for trusts to be governed by the very same people who set them up and benefit from them. Often trusts are laden with bank debts (secured and guaranteed by the family) and have only minimal net asset valuations. It is common for family members to exert effective control over the assets.

This is all rather unusual when compared with international best practice.

Many people in NZ have assets held in trusts in circumstances where they receive only limited benefit from the arrangements.

In many cases the trusts may just add unnecessary complexity and expense to people's lives. This soon becomes apparent when the family is refinancing, buying and selling property, preparing tax returns or adjusting succession planning settings.

Some of these trusts may not withstand scrutiny from the Court because of the way they are set up and/or operated.

Another unique aspect of NZ asset planning is the distinct **lack of genuine independent governance of trusts** and family investment holding entities. In other jurisdictions there is an entire industry dedicated to the proper governance of family wealth. In NZ, most clients would not contemplate appointing an independent professional trustee who is not also the family lawyer or accountant.

A problem with that approach is that the family lawyer or accountant could be conflicted by a long-standing relationship with the people who set up the trust and unaware of, or unable to, fulfil fiduciary duties to the wider family.

Historically, these idiosyncrasies were probably of only academic relevance in NZ. However, there are consequences to this way of doing things. Thousands of trusts in NZ have been set up by Baby Boomers. These trusts are often now pregnant with substantial wealth which the next generation of the family are keen to get their hands on.

Well advised **beneficiaries are scrutinsing the decisions of the trustees** and finding defects in governance which could lead to legal challenges and, ultimately, transactions being invalidated, and trustees being found personally liable.

This also presents potential issues for lenders and other counterparties to transactions with these trusts.

So this is a long winded way of saying I reckon we need to [rethink traditional wealth planning in NZ] and reduce our reliance on trusts as a default setting.

I think we sometimes need reminding of [the importance of a well drafted will].

There are **other wealth planning tools** aside from trusts, like [Family Investment Holding Companies] and [Family Limited Partnerships] and insurance products such as [private placement life insurance] and [captive insurance]

6. Henry discusses the risks he sees to private wealth:

I have a theory that **family assets typically experience linear growth** over a generation but **risks to family wealth increase exponentially** over the same period.

Risk to private wealth can arise in many forms including those illustrated below:

Firstly, I think that far **too much emphasis is placed on the risks** rather than the opportunities that family wealth can provide as a platform for future generations**.**

This is even more pronounced in a tax context. NZ is a relatively benign fiscal environment compared to most developed countries (we have no inheritance, estate or wealth taxes). Even if that changes (which seems likely) the days of using trusts to materially minimize tax are over due to IRD reporting obligations (both domestic and international).

Tax is an impost on profits, but **the biggest risk to private wealth is the people around the dinner table**. If they fall out, then the risks relate to capital and are altogether more destructive – in both financial and emotional terms.

I also think that as advisors we often overestimate our client's risks and don't always adequately consider alternative ways to manage it.

7. Henry discusses the evolution of the family advisory roles:

My academic inspirations include James Grubman and Dennis Jaffe whose articles discussing the tents of "*Wealth 3.0: From Fear to Engagement for Families and Advisors*" has influenced my thinking on this. We could spend hours discussing the topic, but their thesis is that a new approach is needed in mindset and professional services because too often we feed fear and reinforce stereotypes about future generations losing the family wealth. This then becomes a self-fulfilling prophecy because clients become fearful of engaging and collaborating. The reasons for this are rooted in the past 40 years of family wealth advising when a powerful yet flawed approach took hold. They describe this era in three phases:

- **Wealth 1.0**: Prior to 1980 advisors were in a **transactional** only relationship with a primary client who was usually a male, professional business owner. The mandate was to protect and increase wealth.
- **Wealth 2.0**: The modern world of wealth management was born in the late 1970s, 1980s and 1990s. New investment products and services emerged to enrich the middle classes. A lot **more academic thought and research** was published to highlight complexities and psychology of family wealth. An unintended consequences was **fear-based, unnecessarily pessimistic messages** that perpetuate stereotypes. What started as a call to action has often been used to frighten the family into creating restrictive and fear-based plans across generations.
- **Wealth 3.0**: Much from the past 40 years of Wealth 2.0 can and should continue but Wealth 3.0 is a new way of advising which adds greater emphasis on **intrinsic motivation** – the desire to create a good outcome simply because it is the right thing to do,

Unfortunately, **a whole generation of families in NZ have been influenced by Wealth 2.0 advisors** to set up trusts to manage real or perceived risks without much interrogation of the rationale for doing so. Trusts have become the default solution to all problems (real and perceived).

This is all rather curious for a number of reasons including:

- Often the assets held by the trust are encumbered with debt and security to banks or there are substantial settlor and beneficiary current accounts. And so there is not much wealth that is actually being protected by the trust. Trusts are designed to protect assets, not liabilities.
- Often the trust has no income, and even if it does, there are no material tax advantages in NZ to having income producing assets in a trust. If indirect ownership is desirable, then a limited partnership or company may well be more tax efficient.
- Our succession laws are mature and relatively certain. They allow almost unrestricted freedom to benefit whoever we want under our wills. There are some requirements to provide for people to whom we have a moral duty but nothing like the forced heirship regimes that exist in many European and Middle Eastern countries.
- Our laws generally prevent claims being made against individuals for personal injuries caused by negligence. So if we hit a cyclist whilst driving, our nationalised accident compensation regime is

usually engaged to compensate the victim. The same regime applies if a surgeon makes an error on the operating table. In the US a legal action for personal injury or medical misadventure would almost certainly follow such events hence why asset protection trusts are popular there.

- Tax authorities and government agencies nowadays typically look through trusts to the people who set them up and benefit from them.
- Increasingly the same look through approach is being taken by courts in cases involving the dissolution of relationships and recovery of debts.
- We have a very shallow pool of genuine trust law and governance experts and a virtually unregulated fiduciary services sector.
- Another, often overlooked reason why it is somewhat peculiar that we use trusts so often to protect assets is that we have a well-functioning and relatively mature insurance industry.
- A common reason for people setting up trusts is that they are concerned about risks arising from their professional or business activities. Particularly in the case of professionals, I have often found this strategy to be slightly misconceived because it presupposes that the person setting up the trust would go bankrupt rather than pony up to pay a liability which (for the most part at least) should be covered by professional indemnity insurance.
- In any event, transferring the asset in question (e.g. a house) to a spouse prior to taking on the risk is arguably a more robust strategy than to transfer it to a trust over which the professional has control, as so often happens in NZ's "owner-operator" trusts ecosystem.

There is of course often value in having assets in a trust for the reason that it creates complexity and complexity can help negotiate better settlements with creditors. However, the complexity can also have unintended consequences in other aspects of a person's asset plan. As a general principle I prefer to keep the lives of my clients as simple as possible.

8. Henry describes some of the challenges for estate planners:

The family paradigm is different today than what it was 30 years ago. The Society of Trusts & Estates Practitioners recently carried out a research project to gather insight about families and what their wealth and succession planning needs are. It identifies the key complexities and constraints currently facing families and their advisors.

The Report: Meeting the needs of modern families highlights the need for advisors and legislators to adapt and modernise in order to keep up with the needs of today's families. It concludes:

- **Families are changing**, with 'blended', multi-ethnic, and multi-jurisdictional families on the rise.
- **Complexity is often leading to conflict**. Generational and cultural conflicts, cross-border legal and tax conflicts, antiquated legislation, poor succession planning, and deficient legal documents are causing disagreements, breakdowns in family relationships, and litigation.
- **New family constructs and dynamics are driving demand for advisors and their services**. Tax advice, trusts, global/cross jurisdictional services and family governance advice in particular have all seen increased demand and succession planning tops the list of issues on which clients seek advice.
- **There is no longer a one-size-fits-all approach to meeting families' needs**. Traditional structures need to be reviewed in light of new family constructs. Advisors should take a joined-up approach, collaborating with other advisors across borders and professions to ensure the needs of the family are met.
- **Communication and early succession planning are essential** ingredients to success.

Meeting the Needs of Modern Families

Related to this I think that **advisors also need to understand the influence of private international law** (or conflicts of law) when estate planning for families with assets and/or members in more than one country.

In a world where people and capital are globally mobile it is a rare family where this is not a relevant consideration (even if only for FATCA and CRS Reporting because a family member is living abroad).

However, I constantly encounter families and advisors who only view estate planning through a domestic lens.

That oversight can have very adverse consequences that are far more expensive to fix at the back end (e.g. on death) than compared to the cost of proper planning and advice at the front end (e.g. when all relevant stakeholders are alive, well, and in good relations with each other).

In my view, any estate planning done in one jurisdiction needs to take into consideration all other relevant jurisdictions and be synchronised with any estate planning done/to be done in those other jurisdictions.

9. *Henry shares his thoughts on what advisers need to be thinking about for their client's future estate planning success:*

New Zealanders are now starting to enjoy the benefits of private wealth which has been aggregated over several generations.

Much has been made of a **pending tidal wave of family succession and liquidity events** as the Baby Boomer generation transfers assets and control to the next generation. This is part of The Great Wealth Transfer.

There are two typical scenarios:

- a planned and orderly exit (such as a public listing, trade sale, private equity sale, MBO or phased family succession); or
- an exit forced by events and circumstances (such as divorce, family quarrels, death, or incapacity).

In my experience, common obstacles are leading to a **disconnect between strategy and execution** in this area.

What I mean is that wealth owners, lawyers, accountants and bankers all know that succession planning is important but we often fail to fully grasp the human elements at play. Make no mistake, this is not a science, it is all about human behavior around money which is often irrational.

Sometimes intellectually brilliant succession plans are formulated but never see the light of day.

A consequence of this can be that even the most diligent wealth owners often neglect or avoid having meaningful succession discussions. I think this is because of fear based Wealth 2.0 advice.

By the time they really need to engage their position may be weakened and valuations compromised.

Succession is a big challenge, especially when the assets are complex and illiquid. However, families who invest in the process are usually much better off than those who let prevailing circumstances determine outcomes.

A family business succession plan may be quite simple – for example, sell or wind up the business and distribute the proceeds among the family or, alternatively, transfer the business to a “Crown Prince” or “Crown Princess” (i.e. a designated child who has historically been involved in the business) for continued operation.

Some succession plans may be more complex and anticipate equity sharing between siblings, capital raising (public or private), diversification, expansion into new markets or restrictions on issuing equity to non-family members.

For some wealthy families the succession plan might be contained within a family charter to help them with decision-making and to codify a family’s values, mission, and vision.

For other families, the succession plan may be as simple as having a trust (whether created before or on death) which holds equity in the family business and a detailed memorandum to deal with the devolution of control and guide the trustees in the exercise of discretionary powers.

Some business owners may wish to hard wire the future direction of the business by imposing very prescribed rules on the next generation.

Others may be willing to be more flexible and allow them to work within a framework of guiding principles, rather than rules.

Both approaches can work and may involve a combination of traditional estate planning techniques together with corporate and commercial tools, such as put and call options, drag along and tag along provisions, rights of first refusal, rights of pre-emption, redeemable preference shares, shareholder/beneficiary loan accounts, minority shareholder protections, employee share schemes, family share schemes, and earn out provisions, etc.

In my experience, **the best outcomes**:

- occur when succession discussions begin well in advance of any anticipated transition;
- require an in depth understanding of the family dynamics drawn from considerable time and effort in understanding and meticulously documenting all the relevant circumstances;
- involve **engagement** with all stake holders, including family members and management;
- are based on a game plan, which is simple, documented and agreed at the outset before any substantive steps are taken;
- are not tax driven;
- involve the founders taking a leap of faith in the advisors, management and family members;
- involve the **free flow of information** between the lawyers, accountants, bankers and other relevant professionals who work together from the outset, rather than alone in silos;
- are often **led by professionals skilled in the science of human behavior** – rather than lawyers and accountants;
- are predicated on **independent valuations and reporting**;
- take into consideration financial products such as insurance to manage risk and annuities to manage cash flow and services such as wealth management, where there is liquidity;
- distinguish between the very different functions of advice, management and governance; and

- Recognise the value of **independent governance**, whether that be at trust or company level (and in this regard, the family lawyer and accountant may not always be "independent" and perhaps should

- concentrate on advice rather than governance, which involves a different and much wider set of fiduciary responsibilities).

- A well-designed family business succession plan can articulate the vision and values of the founders and help ensure a smooth transition to new owners or the next generation.

- There are many examples where careful and sometimes innovative planning has led to the aggregation of wealth and inter-generational prosperity for future generations of the family and the communities in which they live and work.

Philanthropy may also be an important feature in any such plan. Again I think we can learn a lot from other jurisdictions in this area and **families should be more strategic in grant making**.

10. Henry's observations on how the Trusts Act 2019 has bedded in:

Some long awaited changes to the law of trusts in NZ have finally been made.

The new law is intended to:

- Make the law relating to trusts in NZ more accessible to people who are not legally trained.
- Clarify core trust principles and essential obligations for trustees.
- Preserve the flexibility of the law.

The new law generally achieves these objectives but **is more of an evolution rather than a revolution** in the law. There has been some commentary that suggests the new law imposes more onerous duties on trustees than currently exist under the law. For the most part this is misconceived and the basic duties and powers contained in the new law already existed. The problem is that they are not well known or properly applied in NZ.

One of the reasons for some of the concerns expressed by commentators is that the new law highlights some significant issues for the trustees of trusts in NZ. The trust industry in NZ is unregulated and unsophisticated and, consequently, the quality of governance and administration of trusts is often well below the standards of other countries. It is these poorly governed trusts that the new law is targeted towards but it will result in a higher level of scrutiny on all trusts. This scrutiny is, however, no greater than would be expected in many other countries.

The most controversial aspect of the new law is the **obligation to make available "basic trust information"** to beneficiaries. In NZ it is (regrettably) common for not all (or sometimes any) beneficiaries to be properly engaged with trustees and often beneficiaries are unaware of trusts under which they may have an interest. As a general principle, the new law requires there to be at least a basic level of reporting to all the adult beneficiaries and to the parents/guardians of all the minor beneficiaries.

This is somewhat controversial in a NZ context because most domestic trusts are governed by people (including many lawyers and accountants) who are not well versed in the law relating to trusts. As a consequence trusts are often governed with the interests of the class of beneficiaries as a whole being subordinate to the interests of the people who set up the trust. This is plainly wrong and the new law is intended to raise standards of governance and administration to levels similar to those high standards that have been applied in certain other countries for many years.

Given the vast amount of wealth in NZ that is held in family trusts and the risks associated with being a trustee it is very important that good advice is taken to ensure trusts are compliant and the governance and administration is optimised.

In some situations this may require changes to the terms of trusts (if possible) and/or the current modus operandi for governance and administration.

Another major change is that the IRD has recently finalised the new reporting requirements for domestic trusts in NZ. In summary, most NZ trusts must:

- file an income tax return (form IR6);
- comply with additional disclosures; and
- prepare financial statements.

Although it may not have been the policy intent, I predict that these new rules will accelerate reform to traditional wealth planning in NZ.

Governments are being compelled to repair sovereign balance sheets by raising tax rates and imposing new forms of tax. To inform tax policy Governments are increasingly gathering more information about taxpayers and cooperating with each other to exchange tax information about residents and their wealth. This is one of many examples from around the world where trusts are being targeted.

These new rules may finally motivate some advisors to think beyond the archetypal multiple family trust structure with little or no independent governance, due process, or proper administration and hard wired conflicts of interest.

This could be a positive development. In my view, such more sophisticated but simpler arrangements should involve good old fashioned wills, fewer trusts, and embrace some of the alternative tools I mentioned earlier.